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SUBJECT: EL SALVADOR EXPERIENCING DIFFICULTIES ISSUING SHORT-TERM DEBT

REF: SAN SALVADOR 1084

Summary

1. Because of international financial problems and domestic political uncertainty, the Government of El Salvador (GOES) has been having trouble issuing short-term debt, known as "Letes," which in turn is causing difficulties in complying with its financial obligations. Both banks and foreign investors have been retiring their Letes, rather than rolling them over, and the GOES has \$424 million in Letes coming due between November and March. The market problems with Letes have been serious enough to prompt the Government of El Salvador (GOES) to request technical assistance from the U.S. Treasury. The initial Treasury visit revealed both structural problems in the market and deeper political and confidence issues with Letes. Post will report details on the Treasury Office of Technical Assistance (OTA) visit septel. End summary.

BACKGROUND

2. Letters of Treasury (Letras del Tesoro Publico), known by their Spanish acronym "Letes," are short term debt instruments issued by the government designed to smooth out temporary fluctuations in government revenues. Letes are non-interest-bearing money-market instruments, issued at a discount from face value, with the holder receiving face value when the security matures. Generally, Letes have terms of 90, 180, 270, or 360 days. Normally, the interest rate offered is based on a spread over the six months LIBOR as reported by Barclays Bank on the day of adjudication. Letes are exempted from income tax and have sovereign guarantees.

3. The issuer for Letes is the Ministry of Finance, although the sale process is carried out by the Central Bank. The committee for the adjudication of Letes is formed by officials of the Ministry of Finance and the Central Bank, who will either accept or reject offers based on the state's current requirements. Investors must be registered and authorized by the Ministry of Finance and in the stock market. Since 2005, LETES are sold on the Salvadoran stock market. New LETES are negotiated every other Tuesday, although, depending on needs, extraordinary negotiations may be conducted on other days of the weeks. The main buyers of Letes have traditionally been pension funds, banks, and investment funds. During 2008, the Ministry of Finance has carried out 24 negotiations of Letes and expects to have 8 more before the end of the year. The rates obtained have varied between 3.7% and 6.42% through September 2008.

PROBLEMS IN RECENT EMISSIONS

¶4. According to Carlos Gustavo Salazar, General Treasury Director at the Ministry of Finance, the market started drying up in June 2008, and it has become more and more difficult to sell Letes. In his view, this is driven by a combination of the international financial crisis and local uncertainty because of El Salvador's 2009 elections. Both the banks, due in part to an increase in their reserve requirements (reftel), and foreign investors have begun to retire their Letes rather than roll them over.

¶5. At the end of September, the Ministry of Finance tried to sell \$25 million in Letes, but was only able to place \$228,000. In the first week of October, the GOES was able to place \$38 million, but it had to offer a relatively higher interest rate (7.75%) and a shorter 75 day term (to December 23). On October 14, 2008, the government decided to suspend the planned Letes negotiation because of a lack of interest from banks.

¶6. Minister of Finance William Handal announced in October that the GOES would sell Letes to the Central American Bank for Economic Integration (CABEI). CABEI purchased around \$50 million during the second week of October and has offered to purchase another \$50 million during the last week of October.

MORE PAYMENTS COMING DUE

¶7. If the GOES continues to be unable to roll over Letes, they will have to make several large payments: \$65 million in November, \$68 million in December, \$97 million in January, \$58 million in February, and \$136 million in March. According to Salazar, the GOES only has enough resources to pay the Letes due until November. The GOES is investigating a number of different options, but has not

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identified any solutions.

¶8. Comment: The seriousness of the GOES's current fiscal and liquidity situation is underscored by their request for "emergency" technical assistance from the U.S. Treasury. OTA's initial visit revealed both structural problems in the market and deeper political and investor confidence issues with Letes. Post will report on details of the OTA team's visit septel. End Comment.

Glazer